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No. 92-108

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1992

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BRYSON PROPERTIES, XVIII,
*Petitioner,*

v.

THE TRAVELERS INSURANCE COMPANY,
*Respondent.*

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**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit**

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## RESPONDENT'S BRIEF IN OPPOSITION

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## QUESTIONS PRESENTED

1. Whether a Chapter 11 debtor in its plan of reorganization may classify the unsecured deficiency claim of a nonrecourse secured lender separately from other unsecured claims for the sole purpose of manipulating voting on the plan in order to gain access to the "cram down" provisions of 11 U.S.C. § 1129(b)?

2. Whether the plain language of 11 U.S.C. § 1129(b)(2)(B) prohibits confirmation of a plan of reorganization pursuant to which the partners of a partnership debtor will retain their ownership interests in the debtor even though unsecured creditors will not be paid in full?

## RULE 29.1 LISTING

The Travelers Insurance Company is a corporation. The parent company of The Travelers Insurance Company is The Travelers Corporation, the stock of which is publicly traded. The Travelers Insurance Company has one partially-owned subsidiary, Applied Experts Systems, Inc.

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## RESPONDENT'S BRIEF IN OPPOSITION

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### STATEMENT OF THE CASE

Petitioner Bryson Properties, XVIII the "Debtor"), the debtor in a Chapter 11 bankruptcy case, has asked this Court to review the opinion and judgment of a unanimous panel of the Court of Appeals for the Fourth Circuit, which reversed confirmation of the Debtor's Third Amended Plan of Reorganization (the "Plan") because the Plan's treatment of Respondent The Travelers Insurance Company ("Travelers") is not "fair and equitable" within the meaning of 11 U.S.C. § 1129(b). App. at 2a.[1]

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[1] "App." means the Appendix to the Petition for Writ of Certiorari filed with this Court; "J.A." means the Joint Appendix filed with the United States Court of Appeals for the Fourth Circuit.

**A. Proceedings in the Bankruptcy Court.**

The Debtor is a limited partnership organized under Illinois law, with the principal place of business of its general partner now located in Durham, North Carolina. The Debtor purchased its sole asset, a complex of three comercial office buildings in Omaha, Nebraska, known as "Mid America Plaza," in November, 1986. The Debtor bought Mid America Plaza subject to a first mortgage in favor of Travelers and assumed the seller's obligations to Travelers under a ten-year nonrecourse promissory note in the original principal amount of $10,800,000, which is due and payable in full on June 1, 1995.

The Debtor paid Travelers according to the terms of the note for approximately three years, then defaulted. The Debtor has not made any payments required under the note since June 1, 1989. J.A. at 14.

In September, 1989, after losing an anchor tenant, discovering asbestos in all three of its buildings, experiencing a soft real estate market in Omaha, and receiving notice from Travelers of its intent to commence foreclosure proceedings, the Debtor filed a voluntary petition to reorganize under Chapter 11 of the Bankruptcy Code with the United States Bankruptcy Court for the Middle District of North Carolina.

As of the commencement of this case the Debtor owed Travelers $11,234,306. J.A. at 14. In February 1990 the Bankruptcy Court valued the Debtor's interest in Mid America Plaza at $7,905,068. *See* J.A. at 47. The Bankruptcy Code provides that Travelers' secured claim is limited to the value of the Debtor's interest in Mid America Plaza. 11 U.S.C. § 506(a). In Chapter 11 Travelers is also allowed an unsecured claim against the Debtor equal to the amount of its deficiency, $3,329,238.[2] 11 U.S.C. § 1111(b).

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[2] Outside of bankruptcy Travelers would not have a deficiency claim against the Debtor under the terms of its nonrecourse note.

In the Plan the Debtor divides claims and interests into eight numbered classes: (1) administrative expenses; (2) tenant security deposits; (3) secured tax claims; (4) Travelers' secured claim; (5) the unsecured claim of Continental Bank; (6) the unsecured claims of trade creditors; (7) Travelers' unsecured claim; and (8) equity interests of the Debtor's partners. J.A. at 123-24. The Debtor proposes to pay administrative expenses, tenant deposits and tax claims in full. J.A. at 126-27.

In the Plan the Debtor proposes to pay only interest on Travelers' Class 4 secured claim at rates ranging from 9.25% to 10.5% for ten years, with a balloon payment of the allowed amount of Travelers' secured claim and accrued interest, approximately $8,126,014, at the end of the ten-year period. The Debtor also proposes to pay 3.5% of the allowed amount of all unsecured claims in full satisfaction of those claims; however, because one of the Debtor's limited partners guaranteed payment of Continental Bank's unsecured claim and the Debtor's general partner is liable to trade creditors under applicable state law, the Plan also states that the balance of all unsecured claims except Travelers would be paid in full by the Debtor's partners within thirty days of confirmation of the Plan.

Even though Travelers' unsecured claim will not be paid in full under the Plan, the Debtor proposes that its partners retain their equity ownership interests by making a new capital contribution to the Debtor consisting of $625,000 in cash and providing for an $850,000 line of credit. Only if Mid America Plaza is sold within ten years will Travelers receive a limited return on its claims, and then only after the Debtor's partners have recouped their new "investment." [3]

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[3] If the property is sold or refinanced within ten years, Travelers will receive thirty-three percent (33%) of the proceeds from the sale or refinancing after deducting the following: payment of $7,905,068 to Travelers, the outstanding balance of its secured

Travelers objected to confirmation of the Plan for many reasons, including the Debtor's separate classification of unsecured claims and the retention by the Debtor's partners of their ownership interests even though Travelers' unsecured claim would not be paid in full.

In June, 1990, at the hearing on confirmation of the Plan, the Debtor did not present any evidence justifying separate classification of Travelers' unsecured claim. *See* J.A. at 144-70; *see also* J.A. at 49-117 (transcript of hearing on confirmation of Debtor's Second Amended Plan of Reorganization). Nevertheless, the Bankruptcy Court concluded that separate classification of Travelers' unsecured claim was proper and that the Plan's treatment of Travelers was "fair and equitable." J.A. at 169. The Court then confirmed the Plan under the "cram down" provisions of 11 U.S.C. § 1129(b).[4] *Id.* On June 26, 1990, the Bankruptcy Court entered an order confirming the Plan which contained no specific factual findings, but concluded that the Plan's treatment of Travelers' claims was "fair and equitable" and not "unfairly discriminatory." App. at 37a-38a.

**B. Proceedings in the District Court.**

Travelers appealed from the order confirming the Plan to the United States District Court for the Middle District of North Carolina. On February 8, 1991, the Dis-

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claim; payment of the $850,000 line of credit to be made available by the Debtor's partners; payment of the $625,000 equity contribution to be made by the Debtor's partners; and payment to Travelers of any difference between the principal balance shown on an amortization schedule attached to the Plan (amortizing the original loan amount of $10,800,000 at 5.25%) and the balance of the secured claim. J.A. at 128-29.

[4] Before a plan can be crammed down, at least one noninsider impaired class of claims must vote to accept it. 11 U.S.C. §§ 1129(a)(10), 1129(b)(1). Unsecured creditors in Classes 5 and 6 voted to accept the Plan, thus satisfying this requirement if separate classification of unsecured claims was proper.

trict Court entered a memorandum opinion and order affirming confirmation of the Plan. 129 B.R. 440 (M.D.N.C. 1991) (*reprinted in* App. at 17a-36a).

**C. Proceedings in the Fourth Circuit.**

Travelers appealed from the District Court's order affirming confirmation of the Plan to the Court of Appeals for the Fourth Circuit. On April 20, 1992, a unanimous panel of the Fourth Circuit reversed the District Court's order affirming confirmation of the Plan, and remanded this case to the Bankruptcy Court for further findings consistent with its opinion. 961 F.2d 496 (4th Cir. 1992) (*reprinted in* App. at 1a-16a).

Reviewing the Plan's treatment of Travelers' unsecured claim, the Fourth Circuit first addressed whether the Debtor's separate classification of Travelers' Code-created unsecured deficiency claim and other unsecured claims was proper under the Code. The Court held that while the Bankruptcy Code "does not . . . require that all substantially similar claims be placed within the same class," App. at 9a, a debtor may not classify similar claims separately for the purpose of manipulating voting on a plan. App. at 10a. The Court then held that the justification offered in this case for separate classification —that Travelers' unsecured claim arises from a nonrecourse obligation, whereas other unsecured claims arise from recourse loans—was insufficient to withstand scrutiny. Citing *In re Greystone III Joint Venture*, 948 F.2d 134, 140 (5th Cir. 1991) (as amended on rehearing), *petition for cert. filed*, No. 91-1902 (May 27, 1992), the Court of Appeals pointed out that the distinction between Code-created unsecured deficiency claims and other unsecured claims does not warrant separate classification. App. at 10a. Even if that distinction did warrant separate classification, the Fourth Circuit concluded that "[w]here all unsecured claims receive the same treatment in terms of Plan distribution, separate classification on

the basis of natural and unnatural recourse claims is, at a minimum, highly suspect." *Id.* Because the Debtor failed to offer any other ground to justify classifying Travelers' claim separately from other unsecured claims, the Fourth Circuit held that the classification was "clearly for the purpose of manipulating voting" and "may not stand." *Id.* at 10a-11a.

The Fourth Circuit also addressed Travelers' argument that the plan violated the absolute priority rule, as codified in 11 U.S.C. § 1129(b)(2)(B)(ii), "for the sake of judicial economy." App. at 11a. After reviewing the history of the development of the "new capital exception" in cases decided under the Bankruptcy Act of 1898, the current division among the district courts and bankruptcy courts as to whether the "new capital exception" survived codification of the absolute priority rule in § 1129(b), legislative history and bankruptcy policy, the Court concluded that "the plain words of the statute provide an answer *under the particular facts of this case.*" App. at 11a-14a (emphasis added). Concluding that the exclusive right of the Debtor's partners to contribute new capital constitutes "property" which was received on account of a prior interest, the Fourth Circuit held that the Plan could not be confirmed over Travelers' objection because the Plan did not provide that Travelers' unsecured claim would be paid in full. App. at 15a.

In addition to the analysis of the minimum standard of "fair and equitable" treatment of unsecured claims contained in 11 U.S.C. § 1129(b)(2)(B), the Court of Appeals also held that bankruptcy courts must closely scrutinize plans which only adjust the interests of one creditor under the "broad sense" of the fair and equitable standard of 11 U.S.C. § 1129(b). Under the Plan or through outside payments, all creditors, except Travelers, will be paid in full. Because only Travelers is truly impaired under the Plan, the Fourth Circuit held that "even if some limited new capital exception were viable under the Bankruptcy Code, it would not be so expansive as to apply

*under the facts of this case.*" App. at 16a (emphasis added).

## REASONS FOR DENYING THE WRIT

The Debtor presents two questions for review by this Court in the petition: whether under 11 U.S.C. § 1122(a) unsecured claims must be classified together in a Chapter 11 plan of reorganization, and whether the new capital exception to the absolute priority rule survived enactment of the Bankruptcy Code in 1978. The Court should refuse to review the classification question presented by the Debtor because the Fourth Circuit did not hold that unsecured claims always must be classified together. Instead, like each and every other circuit which has addresed the question, the Fourth Circuit held that unsecured claims may not be classified separately for the purpose of manipulating voting on a plan of reorganization. Moreover, the Court should not take this case to decide the question of the viability of the new capital exception under the Bankruptcy Code, because the issue is not ripe for review and, even if it were, this case would not be an appropriate vehicle to address it.

### I. THE FOURTH CIRCUIT'S HOLDING ON THE CLASSIFICATION ISSUE DOES NOT CREATE A CONFLICT OF AUTHORITY WARRANTING THIS COURT'S ATTENTION.

In the petition the Debtor urges the Court to review this case because the Fourth Circuit supposedly has adopted a "restrictive" approach to classification of claims in Chapter 11 plans of reorganization. The Debtor would have this Court believe that in conflict with a "flexible" approach enunciated by the Sixth, District of Columbia and Third Circuits, the Fourth Circuit has held that all unsecured claims must be classified together. Petition at 17-18, 20. Contrary to the Debtor's characterization of the decision below, the Fourth Circuit expressly stated in its opinion that 11 U.S.C. § 1122 does *not* require that all

unsecured claims be classified together. Instead, the Fourth Circuit held only that separate classification of unsecured claims for the sole purpose of manipulating voting on a plan of reorganization is forbidden. App. 9a-11a. The Fourth Circuit's decision is entirely consistent with the Debtor's so-called "flexible" approach to classification adopted by the Sixth, District of Columbia and Third Circuits. Therefore, review by this Court of the first question posed by the petition is unnecessary.

### A. The Fourth Circuit's Holding Is Misstated in the Petition.

In an attempt to create a conflict between circuits where none exists, the Debtor misstates the Fourth Circuit's holding on separate classification of unsecured claims at several points in the petition. In the first question presented, the Debtor asks this Court to review whether the Fourth Circuit erred "by creating the requirement that all unsecured claims must be classified together where no such requirement exists in the Bankruptcy Code." Petition at i. Later in its petition, the Debtor compounds its error by arguing that:

> By requiring that *all unsecured claims be classified together*, the First, *Fourth* and Fifth Circuits have significantly undermined the negotiation process of Chapter 11 reorganization and placed control in the hands of the large under secured creditor.

Petition at 20 (emphasis added).

Contrary to the Debtor's misreading of the Fourth Circuit's decision, the Fourth Circuit expressly interpreted the requirements of 11 U.S.C. § 1122 as follows:

> Section 1122 requires substantial similarity between claims that are placed in the same class. *It does not, however, require that all substantially similar claims be placed within the same class*, and it grants some flexibility in classification of unsecured claims.

App. at 9a (emphasis added). Recognizing that there is a limit on a debtor's power to classify claims, the Court of Appeals examined the facts of this case and concluded that the Plan's separate classification of unsecured claims was solely for the purpose of manipulating voting on the Plan. App. at 10a-11a. Because the purpose of separate classification was to manipulate voting, the Fourth Circuit held that the classification scheme in the Plan was improper and "may not stand." App. at 11a.

Contrary to the Debtor's assertions, the Fourth Circuit did not hold that all unsecured claims must be classified together in all Chapter 11 plans of reorganization. Therefore, this case does not even raise the first question posed by the petition. For that reason alone, this Court should decline to review that question.

**B. Separate Classification of Unsecured Claims for the Sole Purpose of Manipulating Voting on a Plan Is Prohibited by Every Circuit.**

As the Fourth Circuit correctly observed, classification of claims or interests is governed by 11 U.S.C. § 1122. That section reads:

> (a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.
>
> (b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

11 U.S.C. § 1122.

Because the primary thrust of § 1122 is to insure that claims or interests which are not substantially similar are placed in separate classes, a number of classification rules

are easy to understand. For example, because the claims of creditors and the interests of equity holders are inherently dissimilar, they must be classified separately. 5 *Collier on Bankruptcy*, ¶ 1122.03 at 1122-07 (15th ed. 1992). A plan of reorganization also must separately classify secured claims, priority unsecured claims and nonpriority unsecured claims. *Id.* at 1122-10.

The plain language of § 1122 does not specify whether all claims which are substantially similar, such as unsecured claims, must be placed together in one class. The leading case on this issue is *In re U.S. Truck Company, Inc.*, 800 F.2d 581, 584-87 (6th Cir. 1986). Because the legislative history accompanying § 1122 makes reference to codification of "current case law surrounding the classification of claims and equity securities," S. Rep. No. 989, 95th Cong., 2d Sess. 118 (1978), *reprinted in* 1978 *U.S. Cong. & Admin. News* 5787, 5904, the Sixth Circuit looked to pre-Code case law decided under the Bankruptcy Act of 1898[5] to resolve this question. Because cases interpreting Chapter X of the Act required that similar claims be classified together, while cases interpreting Chapter XI of the Act did not, the Sixth Circuit concluded that debtors may classify similar claims, such as unsecured claims, separately. *Id.* Since the Sixth Circuit decision in *U.S. Truck*, all of the courts of appeals, including the Fourth Circuit in the decision below, which have considered the propriety of separately classifying unsecured claims have concluded that it is not prohibited under § 1122.[6] App. at 9a ("[§ 1122] does not . . . require that

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[5] The Bankruptcy Act was replaced in its entirety in 1978 by the enactment of the Bankruptcy Code, 11 U.S.C. § 101 *et seq.*

[6] The Debtor argues that the United States Court of Appeals for the First Circuit strictly requires that all unsecured claims be classified together. *See Granada Wines, Inc. v. New England Teamsters and Trucking Industry Pension Fund*, 748 F.2d 42 (1st Cir. 1984). Citing case law decided under Chapter X of the Bankruptcy Act of 1898, the First Circuit in *Granada Wines* held that "[s]eparate classifications for unsecured creditors are only justified 'where the

all substantially similar claims be placed within the same class, and it grants some flexibility in classification of unsecured claims"); *Greystone*, 948 F.2d at 138 ("One cannot conclude categorically that § 1122(a) prohibits the formation of different classes from similar types of claims"); *In re Holywell Corp.*, 913 F.2d 873, 880 (11th Cir. 1990) (". . . proponent of a plan of reorganization has considerable discretion to classify claims and interests according to the facts and circumstances of the case . . ."); *Hanson v. First Bank of South Dakota, N.A.*, 828 F.2d 1310, 1313 (8th Cir. 1987) ("We agree that 11 U.S.C. § 1122(a) does not prohibit the placement of substantially similar claims in different classes"); *In re Jersey City Medical Center*, 817 F.2d 1055, 1060-61 (3d Cir. 1987) ("We agree with the general view which permits the grouping of similar claims in different classes").

No circuit supports the Debtor's contention in this case that a debtor should have unfettered discretion to classify unsecured claims separately. The Fifth Circuit in *Greystone* concluded that there is "one clear rule" which has emerged from the fact-based case law on classification: "Thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan." 948 F.2d at 139; *see also In re Lumber Exchange Bldg. Ltd. Partnership*, —— F.2d ——, 1992 WL 143303, *1 (8th Cir. June 29, 1992) (*citing Greystone* with approval). As the Eleventh Circuit explained in *Holywell*:

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legal character of their claims is such as to accord them a status different from the other unsecured creditors . . . .'" 748 F.2d at 46. The First Circuit then concluded that separate classification of an unsecured claim against an employer for withdrawal from a multiemployer pension plan was improper because it has the same legal character as other unsecured claims. 748 F.2d at 46-47. Thus, like the other circuits, even the First Circuit allows separate classification of unsecured claims if the legal character of an unsecured claim is different than the character of other unsecured claims in a particular case.

> If the plan unfairly creates too many or too few classes, if the classifications are designed to manipulate class voting, or if the classification scheme violates basic priority rights, the plan cannot be confirmed.

913 F.2d at 880; *see also Hanson*, 828 F.2d at 1313 ("Classifications designed to manipulate class voting must be carefully scrutinized"). Moreover, the decisions of the Sixth and Third Circuits, which the Debtor would have the Court to believe are in conflict with the decision below, also recognize that there are limits on a debtor's ability to classify claims. *U.S. Truck*, 800 F.2d at 586 ("Unless there is some requirement of keeping similar claims together, nothing would stand in the way of a debtor seeking out a few impaired creditors (or even one such creditor) who will vote for the plan and placing them in their own class"); *Jersey City Medical Center*, 817 F.2d at 1061 (citing *U.S. Truck* and holding that "classification of claims or interests must be reasonable").

In this case the Debtor's sole argument for separately classifying Travelers' unsecured claim from the other unsecured claims is that Travelers' unsecured claim arises from a nonrecourse obligation and the holders of other unsecured claims have recourse against the Debtor and its partners. The courts have found that certain types of unsecured claims are legally distinct and may be separately classified. *Barnes v. Whelan*, 689 F.2d 193, 201 (D.C. Cir. 1982) (distinguishing unsecured creditors/unsecured creditors with claims against a codebtor); *U.S. Truck*, 800 F.2d at 584-87 (distinguishing unsecured trade creditors/union's unsecured claim from rejection of collective bargaining agreement); *In re Mason & Dixon Lines Inc.*, 63 B.R. 176, 179-81 (Bankr. M.D.N.C. 1986) (distinguishing unsecured creditors/pension claimants); *In re Rochem, Ltd.*, 58 B.R. 641 (Bankr. D.N.J. 1985) (distinguishing unsecured trade creditors/tort claimants). One distinction which the circuit courts have agreed does *not* warrant separate classification is that between trade

creditors and unsecured deficiency claims of nonrecourse lenders. *Lumber Exchange*, —— F.2d ——, 1992 WL 143303, *1 ("How the claims of MONY [a nonrecourse lender] and the trade creditors achieved their status does not alter their current legal character and thus does not warrant separate classification"); *Greystone*, 948 F.2d at 140 ("The state law distinction between Code-created unsecured deficiency claims [of a nonrecourse lender] and other unsecured claims does not alone warrant separate classification").

Citing *Greystone*, the Fourth Circuit pointed out that the distinction between a Code-created deficiency claim of a nonrecourse lender and other unsecured claims does not warrant separate classification. There is no contrary circuit court authority on this issue. In addition, leaving aside the question of the legal similarity of such claims, the Fourth Circuit also concluded that separate classification of deficiency claims and trade claims is "highly suspect" where all unsecured claims receive the same distribution under a plan. Presented with no reason for separate classification of claims which "will withstand scrutiny," the Fourth Circuit held that the Debtor's separate classification of Travelers' unsecured claim "is clearly for the purpose of manipulating voting and it may not stand." App. at 10a-11a.

The Fourth Circuit's decision on the classification issue posed by the petition is consistent with the decisions of other circuits recognizing generally that § 1122 allows similar claims to be placed in separate classes, but concluding that separate classification of similar claims for the purpose of manipulating voting is improper. The Fourth Circuit's decision, which is based on the facts of this case, does not create a conflict of authority worthy of this Court's attention. The Court should deny the requested writ to review this question.

## II. THIS CASE IS NOT AN APPROPRIATE VEHICLE FOR ADDRESSING THE CONTINUED VIABILITY OF THE NEW CAPITAL EXCEPTION.

The Debtor argues that review of the second question presented by the petition, whether the new capital exception to the absolute priority rule survived enactment of the Bankruptcy Code in 1978, is required because a "definitive decision from this Court on this unanswered question is essential to resolve the conflict which sharply divides the circuits and lower courts." Petition at 21. The Court should decline to review the second question presented because this issue is not ripe for review by this Court and because the issue is not squarely presented on the facts of this case.

In *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), this Court held that a plan of reorganization was not "fair and equitable" within the meaning of the Bankruptcy Act if it allowed the debtor's owners to retain their interests in the reorganized debtor without first paying all creditor claims in full. This holding is now simply referred to as the "absolute priority rule." Under the Act, the absolute priority rule applied to all classes of claims in a plan, including those classes which had voted to accept the plan, if even one creditor dissented. *See Los Angeles Lumber*, 308 U.S. at 114. Therefore, under the Act the only way in which equity holders could retain an ownership interest in the reorganized debtor without paying senior classes in full was through unanimous approval of the plan by all creditors. *See In re Winters*, 99 B.R. 658, 662 (Bankr. W.D. Pa. 1989). It was in the context of the Act, under which even a single dissenting creditor could prevent any continuing equity participation absent payment in full, that this Court suggested an exception to the absolute priority rule. The *Los Angeles Lumber*. Court wrote:

> Where [the] necessity exists and the old stockholders make a fresh contribution and receive in return a

> participation reasonably equivalent to their contribution, no objection can be made.

308 U.S. at 121. This came to be known as the "new capital exception" or the "new value exception" to the absolute priority rule. This "exception" allowed equity holders their only opportunity under the Act to retain their ownership interests, when necessary to a successful reorganization, over the objection of creditors.

When Congress enacted the Bankruptcy Code in 1978, it codified the absolute priority rule with some significant modifications as part of the cram down provisions contained in 11 U.S.C. § 1129(b)(2). Specifically, under § 1129(b)(2)(B), a plan cannot be confirmed over the objection of a class of unsecured claims, unless the plan provides: (i) that the holder of each claim in the objecting class receive or retain property of a value equal to the allowed amount of such claim on the effective date of the plan, or (ii) that the holder of any claim or interest junior to the claims of such class will not receive or retain under the plan any property.

The most notable change in the absolute priority rule as codified is that, as part of the cram down provisions, it now applies only to members of a rejecting impaired *class* of claims or interests, not to individual claims. As long as all impaired classes of claims or interests vote to accept a plan, the plan may be confirmed under § 1129(a) and a dissenting creditor in an accepting class cannot invoke the absolute priority rule.[7] Thus, unlike the situation under the Act, a plan which proposes to allow equity holders to retain their interests even though one or more senior classes is not being paid in full may be confirmed under the Code even if a dissenting creditor is present, if the class containing the disenting creditor has accepted

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[7] The proponent of a plan still must demonstrate that a dissenting creditor in an accepting class will receive at least as much as it would receive in a Chapter 7 bankruptcy case. 11 U.S.C. § 1129(a)(7).

the plan.[8] In light of the Code's substantial modification of the absolute priority rule as applied under the Act, it is not surprising that the new capital exception does not appear in § 1129(b) or in any other provision in the Bankruptcy Code.

In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), this Court declined to decide whether the new capital exception survived the enactment of the Bankruptcy Code in 1978.

> We need not reach this question [of the continuing vitality of the exception] to resolve the instant dispute . . . we think it clear that even if the *Los Angeles Lumber* exception to the absolute priority rule has survived enactment of the Bankruptcy Code, this exception does not encompass respondents' promise to contribute their "labor, experience and expertise" to the reorganized enterprise. Thus, our decision today should not be taken as any comment on the continuing vitality of the *Los Angeles Lumber* exception—a question which has divided the lower courts since passage of the Code in 1978. [Citations omitted.] Rather, we simply conclude that even if an "infusion of 'money-or-money's-worth' " exception to the absolute priority rule has survived the enactment of § 1129(b), respondents' proposed contribution to the reorganization plan is inadequate to gain the benefit of this exception.

485 U.S. at 203 n.3. For the reasons discussed below, the question left unanswered in *Ahlers* is not yet ripe for consideration by this Court.

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[8] A class of claims is deemed to have accepted a plan if creditors holding two-thirds in amount and a majority in number of the claims in that class which are voted accept the plan. 11 U.S.C. § 1126(c).

### A. There Is No Clear Conflict of Authority Among the Courts of Appeals on the Existence of the New Capital Exception.

One of the principal considerations in this Court's decision to exercise its discretion to review a case on writ of certiorari is whether the decision below conflicts with a decision of another circuit on the same matter. Sup. Ct. R. 10. Because there is currently no conflict among the circuits on the question of the continued vitality of the new capital exception, the second question presented is not ripe for review by this Court.[9]

Prior to this Court's decision in *Ahlers*, the Sixth Circuit applied the new capital exception in a case before it without discussing the effect of the adoption of the Bankruptcy Code on the exception. *U.S. Truck*, 800 F.2d at 588. Since the decision in *Ahlers*, however, the courts of appeals have been reluctant to rule on the viability of the new capital exception.[10] For example, in 1990, Judge

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[9] The Fourth Circuit's application of the plain meaning of the language of § 1129(b)(2)(B) based on the facts of this case is, in any event, consistent with recent decisions of this Court regarding interpretation of the Bankruptcy Code. *E.g., Patterson v. Shumate*, —— U.S. ——, 112 S.Ct. 2242, 2246 (1992) ("In our view, the plain language of the Bankruptcy Code . . . is our determinant") (citation omitted); *Union Bank v. Wolas*, —— U.S. ——, 112 S.Ct. 527, 531 (1991) ("The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning").

[10] Since this Court's decision in *Ahlers*, a number of district courts and bankruptcy courts have considered whether the new capital exception survived adoption of the Bankruptcy Code, with varying results. *Compare e.g., In re Ribs Auto Sales, Inc.*, 140 B.R. 390, 395-96 (Bankr. E.D. Va. 1992) (exception does not exist); *In re Drimmel*, 135 B.R. 410, 415-17 (D. Kan. 1991) (same), *aff'g*, 108 B.R. 284 (Bankr. D. Kan. 1989); *Piedmont Associates v. Cigna Property & Casualty Insurance Co.*, 132 B.R. 75, 79 (N.D. Ga. 1991) (same); *In re Outlook/Century, Ltd.*, 127 B.R. 650, 654-58 (Bankr. N.D.Cal. 1991) (same); *In re Lumber Exchange Limited Partnership*, 125 B.R. 1000, 1006-08 (Bankr. D. Minn. 1991) (same), *aff'd on other grounds*, —— F.2d ——, 1992 WL 143303 (8th Cir.

Easterbrook of the Court of Appeals for the Seventh Circuit undertook a thorough, scholarly analysis of the history of the new value exception, suggested that the new value exception vanished in 1978, but stopped short of that holding. *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1359-62 (7th Cir. 1990). The question remains open in the Seventh Circuit. *In re Snyder*, —— F.2d ——, 1992 WL 156687 (7th Cir. July 9, 1992) (dicta discussing the continued viability of exception, but reserving question for "another day"). In November 1991, Judge Edith Jones, writing for a unanimous panel of the Fifth Circuit, concluded that the new value exception does not exist under the Bankruptcy Code; however, on rehearing in February 1992, the other two members of the panel reversed course and withdrew the portion of the panel opinion on the new value exception over Judge Jones' dissent. *Greystone*, 948 F.2d 134 (as amended).

Since the decision in *Ahlers*, the Eighth Circuit has decided two cases which have assumed the new capital exception's vitality without a discussion of its viability under the Bankruptcy Code. *In re Anderson*, 913 F.2d 530 (8th Cir. 1990); *In re Blankemeyer*, 861 F.2d 192

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June 29, 1992); *Winters*, 99 B.R. at 662-63 (Bankr. W.D. Pa. 1989) (same), *with e.g., In re Sovereign Group 1985-27, Ltd.*, —— B.R. ——, 1992 WL 172641, *2-3 (E.D. Pa. June 30, 1992) (exception survived the enactment of the Code); *In re SLC Ltd. V*, 137 B.R. 847, 850-55 (Bankr. D. Utah 1992) (same); *In re Bjolmes Realty Trust*, 134 B.R. 1000, 1004-08 (Bankr. D. Mass. 1991) (same); *In re Triple R Holdings L.P.*, 134 B.R. 382, 389-92 (Bankr. N.D.Cal. 1991) (same); *In re Woodscape Limited Partnership*, 134 B.R. 165, 168-75 (Bankr. D. Md. 1991) (same); *In re Professional Development Corp.*, 133 B.R. 425, 428 (Bankr. W.D. Tenn. 1991) (same); *In re Tallahassee Associates*, L.P., 132 B.R. 712, 715-17 (Bankr. W.D. Pa. 1991) (same); *In re Mortgage Investment Company of El Paso, Texas*, 111 B.R. 604, 618 (Bankr. W.D. Tex. 1990) (same); *In re 222 Liberty Assocs.*, 108 B.R. 971, 983-85 (Bankr. E.D. Pa. 1990) (same). Conflict among the district courts, however, has never been viewed as a persuasive reason for the exercise of this Court's certiorari jurisdiction. *See* Sup. Ct. R. 10.

(8th Cir. 1988). In *Anderson*, the Eighth Court affirmed the district court's decision to lift the automatic stay because the debtor had not produced evidence sufficient to establish a reasonable probability of a successful reorganization, and noted without comment the district court's holding that the exception existed. 913 F.2d at 532-33. In *Blankemeyer*, the debtor proposed a plan whereby its equity holders would retain their interests in the debtor, and the Eighth Circuit affirmed, without comment, the district court's finding that the equity holders were not contributing "something reasonably compensatory and measurable to the reorganization enterprise." 861 F.2d at 194. Nevertheless, a recent Eighth Circuit decision suggests that the question remains open in that Court. *Lumber Exchange*, —— F.2d ——, 1992 WL 143303, *4 ("Having concluded that Lumber Exchange's plan would not be confirmable without improperly classifying the creditors, we need not address the absolute priority rule, the viability of the new vaiue exception, or whether the plan would be fair and equitable").

In sum, there is hardly a split of authority, much less a clear split of authority, at the circuit level on the second question presented by the petition. Unless and until a clear split of authority between the circuits on the viability of the new capital exception emerges, this Court should defer its consideration of the question.

### B. The Viability of the New Capital Exception Is Not Squarely Presented on the Facts of This Case.

Even if there were a legitimate conflict among the circuits on the issue of the continued viability of the new capital exception, this case would not be an appropriate vehicle in which to resolve that question. First and foremost, the viability of the new capital exception is not an issue which is squarely presented by the facts of this case. As the Fourth Circuit held, *even if the new capital exception existed*, it would not apply under the facts of

this case. App. at 16a. For this reason, the issue of the exception's continued validity is not squarely presented here. The Court should defer its review of the existence of the new capital exception until confronted with a circuit decision which squarely presents the issue.

Second, the Fourth Circuit addressed the vitality of the new capital exception for the "sake of judicial economy," only after concluding that a reversal and remand were necessary on the classification issue alone. App. at 11a. Because the Fourth Circuit's decision to reverse and remand rested first on the Debtor's improper classification of unsecured claims in the Plan, the Court may decide not to reach the second question presented if this petition is granted. Cf. *Ahlers*, 485 U.S. at 203 n.3 (declining to resolve question of continued validity of new capital exception because it was not necessary "to resolve the instant dispute"). The Court should wait to review the viability of the new capital exception in a future case in which resolution of that issue is clearly required.

Finally, resolution of the second issue presented would have no effect on the outcome below. The Fourth Circuit held that even if the new capital exception survived and applied here, this Plan was still not confirmable because it was not fair and equitable to Travelers. App. at 16a. This alternative holding that the Plan was not fair and equitable, whether or not the new capital exception exists, was based on the recognition that satisfaction of the minimum requirements of 11 U.S.C. § 1129(b)(2) does not end the court's analysis on the "fair and equitable" issue. Instead, a court applying the fair and equitable standard must review "the entire plan in the context of the rights of the creditors under state law and the particular facts and circumstances" of the case. *In re D & F Construction, Inc.*, 865 F.2d 673, 675 (5th Cir. 1989) (technical compliance with the requirements of § 1129(b)(2) does not assure that a plan is fair and equitable); 5 *Collier on Bankruptcy*, ¶ 1129.03 at 1129-72 (15th ed. 1992) ("[A] plan which satisfies the standards

set forth in section 1129(b)(2) may or may not be 'fair and equitable' "). Based on the facts of this case, namely, that only Travelers was truly impaired under the Plan, the Fourth Circuit concluded that the Plan was not fair and equitable and could not be confirmed even if the new capital exception existed. App. at 16a. Resolution of the second issue presented in the petition, therefore, would have no effect on the validity of the judgment below. To insure vigorous advocacy on the issue, the Court should wait for a case in which resolution of the new capital exception issue bears on the outcome below.

For all these reasons, this case is not an appropriate vehicle for the Court to review the second question presented in the petition, even if it were ripe for review.

## CONCLUSION

None of the factors ordinarily considered by this Court in agreeing to review a lower court decision are present in this case.

This Court should deny the requested writ.

Respectfully submitted,

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